Political Government and Economic Government in J.R. Commons' Institutional Economics

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ABSTRACT

This article discusses the major work of the American institutionalist J. R. Commons, "Institutional Economics." In this book, Commons argues that institutions are constantly changing due to two conflicting forces: the political government ("sovereignty") and the economic government (the alliance between the pay community and industry). This finding sheds some light on the largely unknown origin of the works of several French monetary institutionalists. I conclude this article with a discussion of another aspect of the theory of institutional reformation in "Institutional Economics," examining the development of French monetary institutionalism.

1. INTRODUCTION

John Rogers Commons viewed the money market ("debt market," in his definition) from the perspective of institutional reformation. In his analysis of the money market, he dedicated more than 250 of the 921 pages of his major work, "Institutional Economics" (IE, henceforth), to this topic (Commons, 1934). In a recent and important work, Dutraive and Théret (2013) disclose the substance of IE and discuss it from the perspective of French monetary institutionalism. Distinguishing between "political sovereignty" and "monetary sovereignty," Dutraive and Théret (2013) explain the evolution of the debt market as a phenomenon driven by the connection and conflict between these two types of sovereignty. While French monetary institutionalism employs the classifications of political and monetary (or economic) sovereignty, Commons used none of these terms. "Political sovereignty" in Dutraive and Théret (2013) corresponds to "sovereignty" in IE. The first question I pose in this article (which I discuss in the following section) is whether it is possible to identify a word in IE that corresponds to "monetary sovereignty" in Dutraive and Théret (2013).

I argue that the political government and its sovereign power correspond to "an economic government of bankers" and its "economic power," in Commons (1934, p. 895). The term I confront with "economic government" is "political government" (Commons, 1934, p. 895). While Dutraive and Théret (2013) derive the comparison between political sovereignty and monetary sovereignty from IE, I base the comparison directly on the text of IE.

In Section 3, I show how the political (federal-level, state-level) government and economic government relate to each other in the evolution of political economy. First, I address the relationship between sovereignty and the pay community in the evolution of political economy (Section 3.1). “A pay community is the concerted action of creditors and debtors in setting up a procedure for the release of debts” (Commons, 1934, p. 457); in modern capitalism, it is embodied by bankers. I present the evolution of political economy as a process in which sovereignty regulates the pay community, seen as a private business custom. Sovereignty regulates the pay community following a code of public purpose(s). The public purposes presented in IE are three necessary conditions for “reasonable” transactions: equal opportunity, fair competition, and equality of bargaining power. I recognize this evolution as the progression towards a reasonable capitalism. However, IE sees the evolution of political economy from the point of view of bankers. In other words, IE explains such evolution as the process whereby bankers accumulate economic power using the legal foundations of sovereignty (Section 3.2). The discussion of such evolution in IE implies that the economic government, resulting from an alliance between the pay community (the bankers) and industry, will end up controlling the political government (Commons, 1934, p. 773).

A second question I pose in this article relates to whether it is possible to articulate the two perspectives in IE’s theory of institutional reformation. I attempt to discuss the relationship between the political and economic government within the framework of IE’s theory of institutional reformation (Kitagawa, in press b). On the one hand, the political government tries to regulate the collective action of the economic government through a code of public purposes. On the other hand, the economic government seeks to expand its economic power. We suggest that, based on these two motivations, the conflict between these two collective actions is the key determinant of the reformation of institutions. Further, applying the conflict between the political and economic governments to the framework of institutional reformation, we suggest that not only the sovereign (physical) and economic powers play a role in institutional reformation, but the ethical power matters as well. In conclusion, to correct the “unreasonable” capitalism, where the economic government acquires a dominant position, the strength and persistence of the ethical power in both the political government and bottom-up movements are of critical importance.

2. MONETARY SOVEREIGNTY AND ECONOMIC GOVERNMENT

In this section, I address two issues: First, I discuss the meaning that French monetary institutionalists attach to the expression "sovereign power of money," (called "economic power" in IE). Second, I compare IE's view that money has "the place of supremacy" with the French monetary institutionalists' "place of sovereignty."

In IE, Commons defines "sovereignty" as follows:

"Sovereignty is the extraction of violence from private transactions and its monopolization by a concern we call the state. But sovereignty has been looked upon as an entity as well as a process. As an entity it is personified as The State, and seems to exist apart from the people. As a process it is the extraction of the sanction of violence from what had been considered to be a private affair, and the specialization of that sanction in the hands of a hierarchy of officials guided by working rules and habitual assumptions. Sovereignty, thus, is the changing process of authorizing, prohibiting, and regulating the use of physical force in human affairs." (Commons, 1934, p. 684)

The definition of sovereignty in IE is the monopoly of physical power. This is the power to define rules (constitution, statute, legal precedents, etc.) and enforcing these rules (court decisions, administration, etc.). Money is not related to this definition. Next, I examine the discourse of French monetary institutionalists regarding money and sovereignty. In the words of Dutraive and Théret (2013):

"The money acquired in IE the full status of institution and becomes a mediation of interactions between the state and the market economy. In other words, the money enters (the order of) the sovereignty and became an organ influencing the course of its evolution and the evolution of capitalism. […] This 'money as an institution directly involved in the genesis of modern sovereignty' and can be considered a component of the government of society, a proper participant of the sovereignty as the judicial power, can own sovereignty as the judiciary, but also that, in its contemporary form of credit money, it tends to apply for a position of sovereignty for itself, breaking with political sovereignty, because of its economic and symbolic power and its own social force." (Dutraive & Théret, 2013, pp. 84, 96)

Aglietta and Orléan (1984) discuss money and sovereignty as follows:

"The money is in commercial order the principle that establishes social cohesion; it is from the principle that can form and compare the evaluations of private subjects; it is from the principle that proceed the payment constraints, the variability of their intensity; that allows the integration of commercial activities. Wanting to focus on standards and morphogenetic dimension of this process, on the action that implies in defining social relationships, we called the process principle of sovereignty. Monetary theory is a theory of sovereignty because it defines a specific logic of social relations, especially domination and asymmetric effects." (Aglietta & Orléan 1984, p. 4)

In contrast with Aglietta and Orléan (1984), Aglietta and Orléan (1998) also cover the topic of debt, but there is no other essential difference between the two works. In Aglietta and Orléan eds. (1998), the authors refer to "sovereign" for something that holds the supremacy, and is in the position of mediating social relations. The source of power of sovereign money is the fact that each individual is subject to two money-based pressures. First, market participants who disagree with the unit of currency are exposed to a pressure to leave that particular market. Second, market participants who disagree with the rules regulating the use of money also receive pressure to leave the market (Sakaguchi, Nakano, & Nakahara, 2012, p. 613).

In IE, a normative restriction is associated with an "economic sanction" or "economic power:"

"We need to […] inquire, what are the sanctions by which Knapp's 'pay group' enforces upon participants the acceptance and use of that instrument of release. They are not only the 'legal sanctions' of physical force, to which a purely 'state theory' is limited, but they are also the moral and economic sanctions of what he designates 'private pay-communities.' The legal sanctions are 'extra-legal,' for they are customary tender or customary performance. Take his instance of a commercial bank and its customers: What compels the customers to accept, in full payment of debts owing them, the demand-debts of a solvent bank evidenced by such a 'ticket' as a depositor's check? These bank debts are not legal tender, either by statute law or common law, enforced by physical force——they are customary tender. Yet their acceptance by creditors, within customary limits, is economically, compulsory, because anyone who wishes to do business or to continue in business in that community must accept these checks. If he persistently refuses them and always demands legal tender in payment, nobody within

that pay-community will enter upon the ordinary business transactions with him. He is as effectively compelled to accept the customary tender of 'good' bank checks in payment of debts owing him as he is compelled to accept legal tender. It is not only a matter of convenience with him, nor only a voluntary choice of alternatives, nor only the expectation that he in turn as a debtor can also pay his own debts with the same or equivalent bank checks, nor the expectation of redemption in legal tender——it is a matter of economic compulsion. It is the economic sanctions of competition, ending in profit or loss, success or bankruptcy, that enforce acceptance of the customary tender of bank checks. So that ultimately nine-tenths of the debt payments in the United States are accomplished, not by legal tender, but by customary tender." (Commons, 1934, pp. 461–462)

IE argues that, due to this economic power (economic sanction), money represents sovereignty. French monetary institutionalists support a similar argument. As discussed above, Commons (1934, p. 684) perceives sovereignty as the monopoly of physical power, or "the specialization of that sanction in the hands of a hierarchy of officials." With respect to economic power, IE discusses its "entity" and "process," which correspond to the entity monopolizing physical power and the process of specialization of that power, respectively. "An economic government of bankers" that, de facto, controls certain industries corresponds to the entity of sovereignty, the monopoly of physical power, and, according to Chapter XI of IE, to the process in which "the alliance of banking and industry" specializes and exerts its economic power (Commons, 1934, pp. 891, 895; see Section 3). The economic government to which Chapter XI of IE refers to is the nexus between the pay community and "big businesses" (Commons, 1934, p. 888):

"It is not needful for American capitalism to combine all competitors in a single holding company. It is only needful to combine the strongest companies and the strategic companies. These include the companies that own the natural resources, the companies that do the intermediate manufacturing and transportation, the companies that own trade-marks, good-will, and patents which furnish access to the patronage of customers, and the great bankers who finance the company. This is Integrated Capitalism, or Banker Capitalism, because the integration can be financed only by bankers." (Commons, 1934, pp. 895)

"Integrated capitalism" is the economic government of bankers. The economic

government is compared to sovereignty, that is, the "political government." The economic government's "sanctions are not the physical force of the state— they are more powerful sanctions of credit, profit, and loss" (Commons, 1934, p. 895). Hence, IE considers the economic government superior to the political government.

Table 1 displays some terms used by French monetary institutionalists and the corresponding terms in IE. Studying the use of such terms in IE, especially the contrast between sovereignty and private pay community, or between political government and economic government, we realize how the dynamics of sovereignty and the pay community is discussed in IE.

Table 1: Correspondence between the terms of French monetary institutionalism and the terms used in IE.

Terminology of French monetary institutionalism		
	Political sovereignty	Monetary sovereignty (Economic sovereignty)
Corresponding terms in IE		
Power	Physical power (Sovereign power)	Economic power (Economic sanction)
Entity	Political government	Economic government (the alliance between pay community and industry)
Process	The sanction has been collected in the hands of a hierarchy of officials	The creation of a nexus, supported by bankers, that can control a certain industry

3. POLITICAL GOVERNMENT AND ECONOMIC GOVERNMENT

3.1. Sovereignty and the Evolution of the Pay Community

In IE, money is a mean of payment ("means of release") for debt and a unit of measurement ("unit of validity," "unit of value") for the size of debt.[i] A pay community follows rules that consist of business customs and laws. Private and public rules represent the legal foundations for money to be both a mean of payment and a unit of measurement. Such rules evolved over time. Debt has changed from unnegotiable to

negotiable debt, and from “unreleasable” to “releasable” debt (Commons, 1934, pp. 390). The “negotiability” of debt was established by decisions of the court of equity, which assumed the doctrine of assumpsit from established business customs practiced by merchants and manufacturers (Chapter VII in Commons, 1924). The court’s decision guaranteed the “incorporeal property” created by oral contracts. The amount of releasable debt expanded through the abolition of slavery, bankruptcy laws, “the gradual abolition of term or life contracts for labor by substituting contracts ‘at will,’” and “the prohibition of truck payments and substitution of money payments” in the case of wages (Commons, 1934, p. 458).

It should be noted that, in most cases discussed by Commons, the origin of legal precedents and statutes were business customs. Public rules are rooted in private rules. The legal foundations of the private pay community descend from two kinds of rules: private rules (which are generated and changed by the pay community itself) and public rules (which are established and amended by the political government, with reference to the private rules). The pay community of modern capitalism, descending from both private and public rules, is described as a “transactional system of money and value” (Commons, 1934, p. 510). When money is an institution, a unified “unit of measurement,” the value of debt is created, negotiated, and released. These three steps represent a “turnover.” Each turnover is repeated at a certain speed (“velocity” of turnover), which varies over time. Commons’ (1934, p. 510) “transactional system of money and value” consists of repeated commodity transactions and repeated debt transactions.

“Our formula of a turnover of bargaining transactions [that consists of two buyers and two sellers] has not hitherto included the banker. Yet all modern transactions require the participation of bankers. Even the ‘cash’ payments, usually termed the ‘circulation of money,’ consist in drawing cash from the banks instead of transferring demand debts at the banks. This cash again ‘flows’ into the banks in payment of debts owed to the banks. The banks themselves, if short on this ‘money in circulation,’ call upon the Reserve banks for ‘money,’ thus reducing their balances at the Reserve banks. Or, if long on circulation, they return their ‘cash’ to Reserve banks in order to pay debts to the Reserve bank and thus augment their Reserve balance.
Hence each of the two buyers and two sellers of a bargaining transaction, who make the whole of the debt-payments, must have not only an account at his bank, but also an understanding with the banker as to what he may expect towards obtaining the means of

payment, which the banker will himself create as a deposit for carrying out transactions. Thus our formula for a complete bargaining transaction must have four bankers, one for each of the two buyers and two sellers in the transaction. […] One of each possible commercial transaction, therefore, arises the possibility of various types of short-time commercial debts, whether single name paper, trade acceptances, bankers' acceptances, or otherwise. All have the one fact in common that the sale of a commodity creates a business debts which the banker buys by selling to the business man his own deposit debt. The business debt lasts from one day to 90 days and the transaction is not closed until the debt is paid at the expiration of the time agreed upon. The banker create, in exchange, debts 'past due' and therefore payable on demand, to the extent of the discounted future value of the business debt, and these deposits ae the checking accounts against which the customer immediately draws his check for the payment of other debts which he has contracted in his purchases of materials and labor.
Thus each loan transaction creates its own money. There is not a fund of money that 'circulates,' but there is a repetition of the creation, sale, and payment of short-time debts to the amount equivalent to the discounted values of the titles of ownership alienated. Two succeeding increases in value thus occur, based on forecasts of the prices of commodities: the increase in output of use-value of commodities to be added by the input of labor; and the increase in value of the discounted debt as it approaches maturity." (Commons, 1934, pp. 510–511)

In Figure 1, I schematically illustrate a bargaining transaction.[ii] Commodities represent one side of the bargaining process, and the other side illustrates the creation of debt. Bankers, whose customers are buyers and sellers, are responsible for the creation of debt. Money (referred to as debt, in IE) is not introduced in the market exogenously from the Federal Reserve System, but endogenously, via the credit requirements of a myriad of bargaining transactions in the commodity market. Credit requirements reflect a businessperson's motives for purchases and his/her appetite for investment. Further, credit requirements often depend on the profit margins of his/her business. In this way, one's profit margin is the key piece of information associated with a businessperson's decision-making.[iii]

All participants in the bargaining transaction represented in Figure 1 are involved in both the commodity and debt markets. B and B^1 in Figure 1 represent one of the 48 million buyers in the debt system of Figure 2; S and S^1 represent one of the 48 million sellers. $Banker^B$, $Banker^{B1}$, $Banker^S$, and $Banker^{S1}$ represent one of the 9,000 member or

non-member banks." Bankers act concertedly, in accordance with the provisions of the Federal Reserve System.

Sovereignty (Courts, federal legislature, state legislatures)
Issue: Are public purposes (equal opportunity, fair competition, and equality of bargaining power) accomplished in this transaction?

Regulation by decisions, legal precedent, statutes

	Banker^B		Economic relations		Banker^B1	
Buyers (bid)	$ 100	B	Competition (Opportunity)	B^1		$ 90
Economic and moral power			Power			
Sellers (ask)	$ 110	S	Opportunity (Competition)	S^1		$ 120
	Banker^S				Banker^S1	

Figure 1: A bargaining transaction involving nine parties.

Source: Compiled by the author, based on Commons (1927, chapter I, sheet 15) and Commons (1928, reel 12, sheet 762).

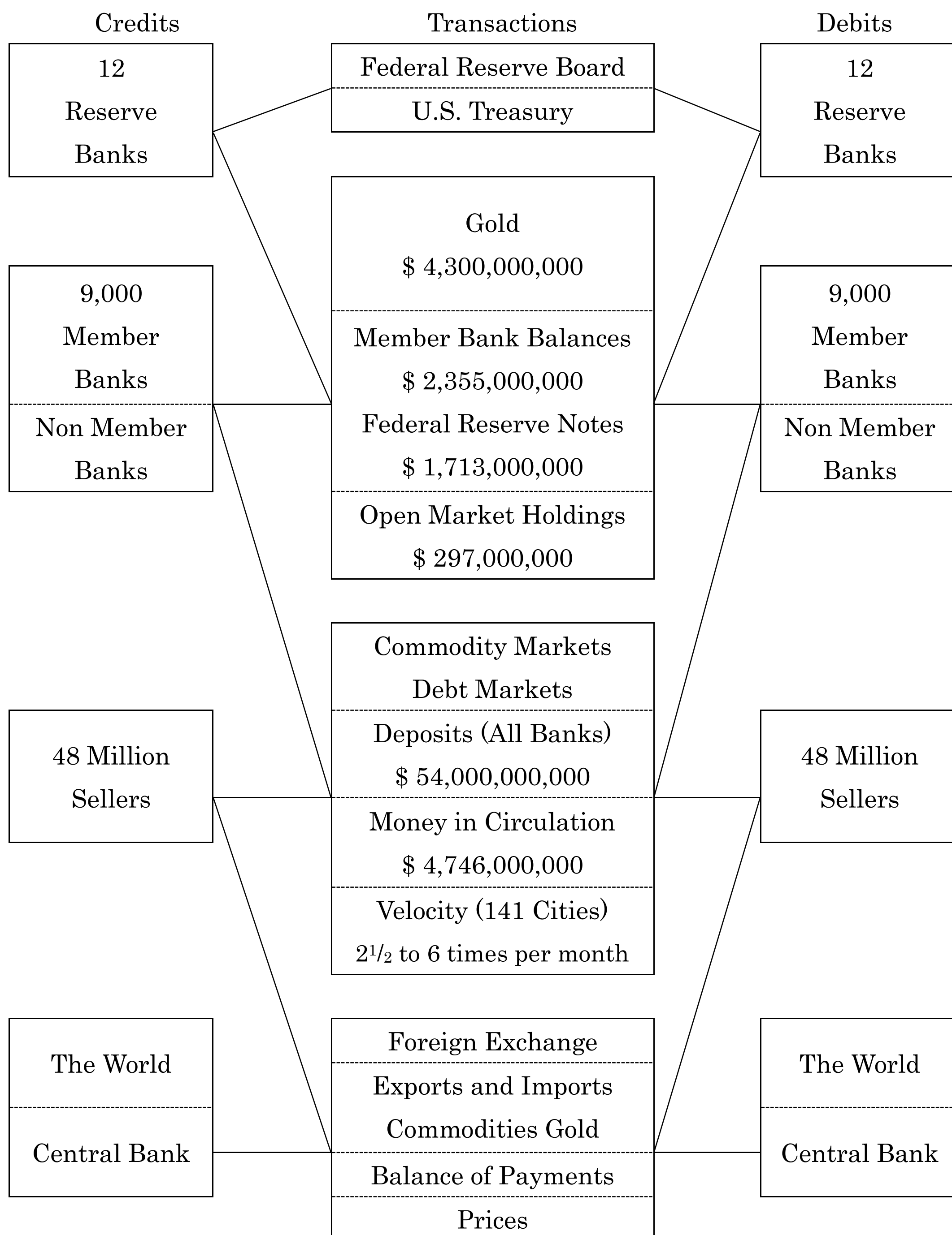

Figure 2: The Debt Market. Credits and Debits as of June 1929
Source: Commons (1934, p. 396, Chart 6)

How does sovereignty relate to the turnover of bargaining transactions (i.e., the creation, negotiation, and release of debt)?

“Legal analysis resolve negotiation between participants of a transaction into persuasion or coercion, fair or unfair competition, equal or unequal opportunity, reasonable or unreasonable price, all of them dominated by scarcity, expectation, and the customary and legal rules of the time and place. Then if these conditions of persuasion, fairness, equality and reasonableness are not met, or disregarded, the court, representing the collectivity, reads into the negotiations, which creates a debt, determined and measured by the […] dimensions of the value.” (Commons, 1934, pp. 524-525)

Thus, if the court observes inequality, unfairness, and unreasonableness in a loan transaction, it addresses it. Federal and state legislatures complement the court decisions, being the legal foundations for the turnover of bargaining transactions. I show two examples below. The first is the “small loan law,” which:

“created licensed companies authorized to charge, on sums of $300 or less, a rate of $3^1/_2$ per cent per month, or 42 per cent year, on unpaid balances, and making illegal any rates on small loans in excess of that rate. This law was adopted by a number of states. It was their standard of the *reasonable* value of the service rendered by loan companies to necessitous small borrowers. Here it is that organized society attempts to offer to the necessitous borrower an alternative, which its spokesmen, the legislature, deem reasonable.
Yet, on first impression the states were legalizing an usurious rate of interest. But, considering the only alternatives previously available to this class of borrowers who were unable to borrow at commercial banks at the usual legal rates of interest, a rate of $3^1/_2$ per cent per month would have been approximately 32 cents.
This, again, is a special case of dis-opportunity-value, or the value to a person of having the opportunity to avoid an alternative higher outgo. Although the rate of $3^1/_2$ per cent is high and usurious compared with what would be paid to commercial banks by persons with good credit acceptable to the banks, yet for the person without credit and in necessitous circumstances, the rate is decidedly less than his next worse alternative rate. He is better off than he would be under his actual economic circumstances, and, although his positive sacrifice is very great indeed at $3^1/_2$ per cent per month, it is less than it would be at 10 or 20 or 40 per cent per month.” (Commons, 1934, p. 335)

In this example, the small loan law– a state law– restrains the bargaining (economic) power of banks, private individuals, and corporations and limits their opportunities to achieve the equality of bargaining power, equal opportunities, and fair competition.

The second example is the Federal Reserve System, established in 1913. This system integrates thousands of banks and takes concerted actions with respect to interest rates and supplied amounts of credits.[iv] The reasons for the creation of this large system include the equalization of bankers' bargaining power and the stabilization of prices and employment.

"Manufacturing industries next [to labor organizations, railways, and public utilities] came within the theory [of reasonable bargaining power], the issue, in their case, culminating in the [1920 U.S. Steel dissolution] cases […]. Then the most comprehensive of all industries, the banking industry, was admitted to the process [of the historical expansion of the theory of reasonable bargaining power], under the Federal Reserve Act which authorized concerted action of eight thousand banks [that increase to nine thousand banks in at June 1929], guided by twelve Reserve banks, in regulating the prices to be charged for, and the volume to be issued of, bank credit." (Commons, 1934, pp. 345–346)

The operations of the Federal Reserve System reflect the concerted actions of a myriad of bankers, buyers, and sellers. Commons envisages the creation of a worldwide system of concerted actions of central banks deciding their rates; he refers to this system as the "world pay community" (Commons, 1934, p. 590). Inspired by Wicksell's suggestion (Wicksell, 1898), Commons highlights the importance of the world pay community, but he is not optimistic about the actual creation of such an international community:

"At this writing, in November 1933, the nations have definitely failed to get together on all questions of national and international conflicts of interests, whether economic, monetary, or military, and the future is unpredictable." (Commons, 1934, p. 611)

In summary, Commons perceives the change driven by sovereignty and the pay community as the process whereby sovereignty provides the legal foundation to create, negotiate, and release debt to the pay community itself. This is a process in which sovereignty regulates the pay community, which was created through business customs, and is in line with public purposes. We see this evolution as a process towards a reasonable capitalism.

3.2. Sovereignty and Formation of the Economic Government

In contrast with the process towards the satisfaction of public needs, in Chapter IX of IE, Commons outlines the process where bankers, symbolizing the pay community, build an economic government through a concentration of economic power. The formation of the economic government implies the alliance between bankers and industrial corporations. Before discussing such alliance, however, it is necessary to address how sovereignty affects corporations.

Sovereignty gave a legal foundation to corporations almost in the same way as in the evolution of the pay community. The key concept is “incorporation.” In the early days of America, only “those which received special charters by act of legislature” became corporations (Commons, 1934, p. 881). “In order to get a charter of incorporation the business men had to align themselves with the politicians” (Commons, 1934, p. 881). At this stage, those with political power took control, as mediators between political parties and capitalists. However, “in order to get rid of political corruption,” state legislatures introduced general corporation laws, starting with the state of New York, in 1848. Corporations “established a new right of business men— the right of association” (Commons, 1934, p. 881).

“Then came a new discovery, thirty years ago, the holding company, invented by the corporation lawyers to evade the anti-trust laws, and enacted first by the legislature of New Jersey. It was not altogether new, for corporations could always own the stocks and bonds of other corporations. Its novelty consisted in creating corporations solely or mainly for the purpose of owing and voting the stocks of other corporations. Other states competed with New Jersey for this profitable business.
Almost unlimited powers were granted to the holding companies, and they had all the privileges in other states which they had in their own state. The only restraint upon them now became the Supreme Court of the United States.” (Commons, 1934, p. 882)

Based on a “per se illegal rule” (any accused, concerted action restricting transactions was illegal), the Supreme Court introduced antitrust laws. . In 1911, the Supreme Court disbanded two holding companies, Standard Oil and American Tobacco. However, the Supreme Court, a judicial sovereignty, had exercised its sovereign power strictly to maintain free competition until the 1910s. In the 1920 U.S. Steel dissolution case, the Supreme Court applied a new criterion for judgment, the “rule of reason.” This rule assumes that public interests must be weighed against the observed and potential

disadvantages of competitive restrictions. As a consequence, restrictions towards holding companies with considerable economic power were softened. Sovereignty provides legal foundations to corporations to exercise their economic power, while sanctions against corporations are enforced only when their actions have a negative impact on public interests.

Large corporations were forced to depend on bankers to raise large amounts of capital. Bankers formed alliances within certain industries, like big manufacturing corporations at the top of an industry, attempting to control them through funding and dispatching executives. A symbolic case of "the alliance of banking and industry" was the merger of Federal Steel (in which J.P. Morgan and E. H. Gary held large proportions of the stock) and Carnegie Steel, which was held by A. Carnegie (Commons, 1934, p. 890). U.S. Steel was established in 1901, funded by big bankers purchasing the capital of big capitalists (Chernow, 1990). U.S. Steel was the first company in American history with capital exceeding one billion dollars. Commons discusses the American capitalism of big bankers and big manufacturing corporations as follows:

"The United States Steel Company, created by a banker syndicate, and sustained by bankers, in some of its branches of manufacture controls less than half of the nation's output. But if a small competitor, in the stress of hard times and lack of orders, ventures to cut prices in order to pull customers away, a mere announcement by head of the [U.S.] Steel Company that it intends to 'meet competition' brings the unruly competitor back to the prices set by the dominant corporation. […] This is American Capitalism. It is an economic government of bankers more powerful than the political government. Its sanctions are not the physical force of the state——they are the more powerful sanctions of credit, profit, and loss. The system looks like the old 'law' of supply and demand and like the economists' principle of marginal utility. Competition still is free, but the sanction has been changed from the economist's satisfaction of wants to the business man's fear of bankruptcy. The little capitalists […] become in America the disciplined followers of Banker Capitalism." (Commons, 1934, p. 895)

The economic government of bankers, however, means more than the concerted action of banking syndicates and big manufacturing companies. As pointed out in the quotation above, it means also explicit and implicit codes of conduct rooted in the "fear of bankruptcy." Small capitalists are inevitably involved in concerted actions based on these codes. Thus, the alliance between banking and industry exerts its economic power

in a different way than a monopoly. With respect to the development of the alliance between banking and industry, a perspective that stresses the formation of a great power is different from one that stresses the restraint on the pay community via political government, to achieve public purposes (discussed in Section 3.1).

We can see a similar description of the Federal Reserve System. In Section 3.1, I discuss Commons' view of a system established to achieve equality of bargaining power— a public purpose. Chapters VIII and IX of IE, written in the period between 1927 and 1929 (Commons 1927; 1928), reflect this view. In his writings after 1929, Commons emphasizes that the political government gradually lost control of the economic government.

"In the public interest and the need to economize the scattered gold reserves in order to furnish a flexible currency, the Congress unites the bulk of the banks in a great Federal Reserve System, like similar central banks of the world. The System makes its own rules and governs its members and borrowers, much like a trade union. The banking system the world over has become the head of the modern system of national and international economic government, not only because the banks sought aggrandizement for themselves but because dire public necessity required unity of operation in place of the older competitive individualism. Great industrial corporations are represented on the boards of directors of the twelve bank boards, and the alliance of banking and industry is complete.
Then the [political] government appoints a Federal Reserve Board to supervise this stupendous banker's [economic] government of its own creation, but with low salaries and insecurity of tenure in dealing with men of fabulous salaries and the shrewdest of ability which modern capitalism enlists in establishing its supremacy." (Commons, 1934, pp. 890–891)

"When the bankers reach the limit of their ability, as in 1932, then the [political] government itself organizes a huge reconstruction finance corporation to relieve the bankers of liability. Meanwhile central banks controlled by bankers rise to a new importance and Banker Capitalism comes into control of industries and nations." (Commons, 1934, p. 773)

Bankers had consolidated a significant economic power in their hands using not only industries, but also their physical power— the authority to construct and amend the

legal foundations of the political government, which is founded upon law. In this way, it is possible to observe the consolidation of an economic power by the economic government. This process, as practiced by the economic government, can be seen in contrast to the process of monopolization of physical power, as practiced by the political government (see Section 2). In IE, Commons does not exemplify the lobbying of bankers. However, he views the political government as an entity, as well as the field of politics – the internal activities of the political government. "Politics" in IE refers to the struggles of interest groups for power within the government. As one of the strongest interest groups, bankers are expected to affect the policy-making process.

4. POLITICAL GOVERNMENT AND ECONOMIC GOVERNMENT IN IE'S THEORY OF INSTITUTIONAL REFORMATION

In the discussion on the origins and evolution of the pay community in Section 3.1 (Chapters VIII and IX in IE), I address the process whereby sovereignty restrains the pay community, in accordance with public purposes. On the other hand, in Section 3.2 (Chapters X and XI in IE), which covers the relationship between the economic government (the alliance between the pay community and industry) and the political government (sovereignty), the economic government seizes a great economic power and starts to control not only small capitalists, but the political government as well.

Is it possible to integrate the two different perspectives on the evolution of political economy? Can sovereignty and the pay community on the one hand, and the political and economic governments on the other hand, coexist in a theory of institutional reformation, as presented in IE? The fact that the two perspectives were presented in the same book and were written by the same author served as an inspiration for this article.

In IE, the theory of institutional reformation integrates two approaches. In the first approach, the emphasis is on the participation of actors mainly belonging to lower-level institutions and their influence on higher-level institutions. The second approach involves the implementation of a collective sanction from certain, higher-level, institutions to lower-level institutions.

In the first approach, Commons assumes that citizens try to: (a) capture the collective power participating in various organizations (Commons, 1924, pp. 105–6); (b) change the working rules exercising the collective power. In IE, Commons argues that citizens

establish a higher institution– a private “rationing transaction”– through concerted actions. Examples of rationing transactions are the establishment of agreements between corporations, employer associations, or trade unions (Commons, 1934, p. 54, 70). Interest groups build such institutions volitionally, or they are constituted by orders of state and federal commissions. The latter represents a rationing transaction with both private and public characteristics; the Federal Reserve Board is one example. In the process of instituting such working rules, the coordination of economic, political, and ethical principles is necessary. Direct participation is not the only way to affect higher institutions; there are two methods available to citizens. First, by launching a legal action, citizens turn to a supreme institution with proper jurisdiction to justify their claim, which is rooted in private organizations, by ethical principles. Second, the citizens’ collective opinion (public opinion) affects the judges’ “habitual assumptions,” or code of conduct, because habitual assumptions consist not only of judicial precedents, but of public opinion and social customs as well. Based on the clarifications established in IE, judges’ habitual assumptions are driven by different principles; for example, “economic assumption” refers to scarcity and efficiency, while “ethical assumption” reflects universalistic ethical principles (i.e., security, freedom, equality, and fairness; Commons, 1934, p. 698).

In the second approach for exercising the collective sanction and inducement from certain upper institution to lower institutions, the judicial branch weighs and evaluates various aspects of a case, in accordance with the habitual assumptions. Then, the judicial branch takes a decision about the case, such as its legality and whether it violates the Constitution. As a result, one institution (custom) is selected from competing institutions in the case. This decision should conform with various (ethical) principles that differ from standard economic principles. In shifting our attention from the judicial branch to the legislature, we see that legislatures concede part of their sovereign power to private going concerns through the arrangement of a commission (Kitagawa, in press a). In doing so, legislatures allow private going concerns to contribute to social governance.

Figure 3 illustrates the two approaches of institutional reformation. We observe a cyclic structure of participations, projections, coercions, and inducements. Economic, political, and ethical principles are coordinated and translated into working rules. In pursuit of the “reasonableness” of political economy, the three conditions of a transaction – equal opportunity, fair competition, and equality of bargaining power – need to be met.

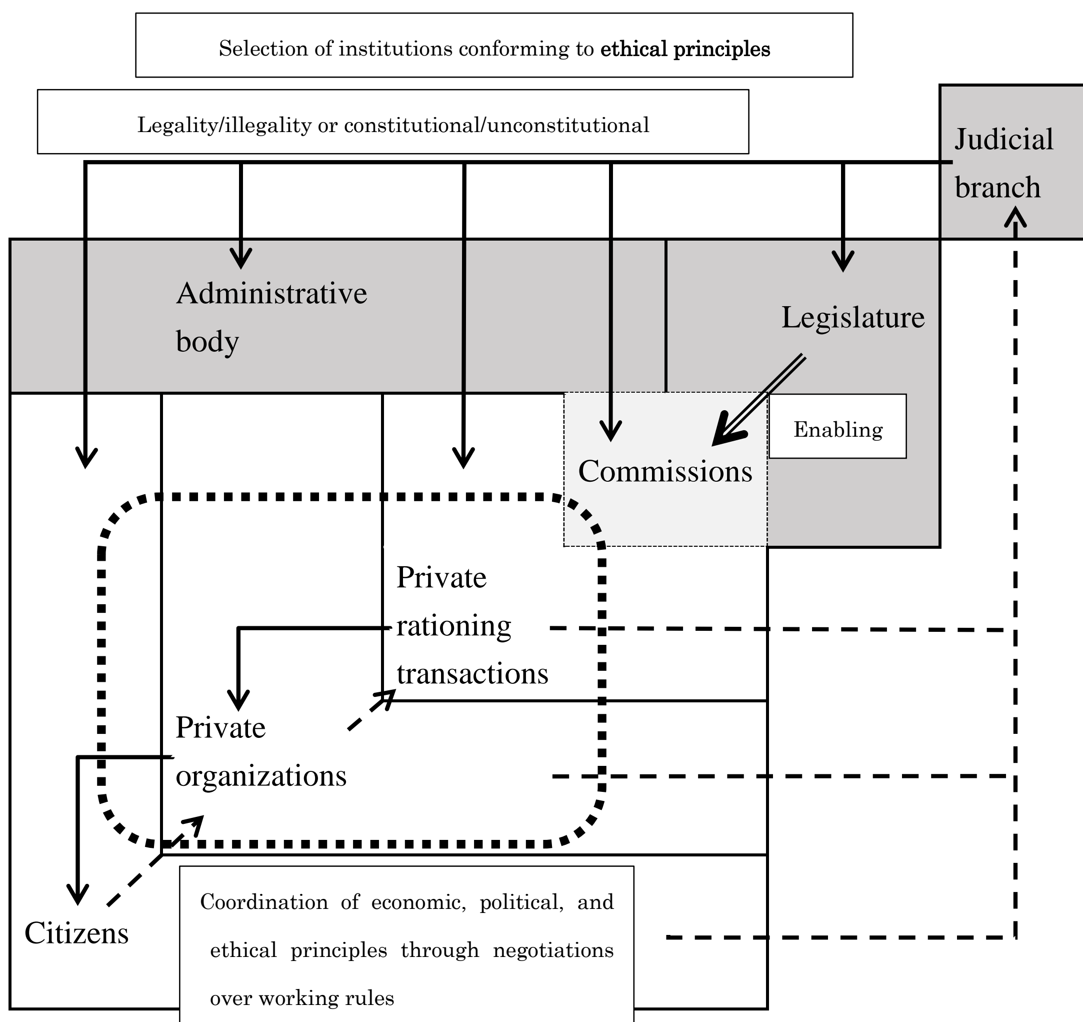

Figure 3: The Relations between Political and Economic Government
The colored parts denote the fields of political government.
The parts outlined by a dotted-lines denote fields of economic government.
Solid arrows indicate that an organization self-servingly and artificially selects an institution within its jurisdiction. If the organization is a judicial branch (especially the federal Supreme Court), it selects the institution artificially, conforming to certain public purposes (ethical principles).
Dashed arrows reflect the fact that a citizen or an organization affects the rule-making process of the upper organization to seize collective power for their own benefit. Economic, political, and ethical principles are coordinated and translated into working rules through the participation in an upper organization and by affecting the rule-making process.
Source: Compiled by the author, based on Kitagawa (in press b).

IE does not address the kind of rationing transaction that the Federal Reserve System represents. For example, if the system is defined as a bargaining process between conflicting interest groups, it is classified as "collective bargaining." If the system is defined as a dictatorship by an interest group, it is a "cooperation." The five members of the Federal Reserve Board are appointed by the federal government. Each board of the twelve federal reserve banks consists of nine members, six of which are selected by member banks, and three of which are appointed by the Federal Reserve Board from an agricultural, industrial, and commercial (non-banking) institution. With respect to the Federal Reserve Bank of New York, there is evidence that Wall Street takes control of the bank's personnel affairs (Nishikawa & Matsui, 1989, p. 150). Considering the personnel system, the Federal Reserve System most accurately represents a cooperation of bankers constrained by a public purpose—the stabilization of prices and employment.

Institutional reformation is driven by both the political and economic government. The political government seeks to rebuild institutions to achieve consistency with public purposes. A judicial branch selects the best action, custom, or working rule for its object from the actions of legislatures, administrative bodies, economic governments, other going concerns, and citizens. The legislatures and administrative bodies also seek to build institutions consistent with the principles of equal opportunity, fair competition, and equality of bargaining power, as well as with the stabilization of prices and employment. Furthermore, these bodies tend to approve private institutions that can adopt these roles. In contrast, bankers and their industrial capitalist allies seek to enhance their economic power and enlarge their jurisdiction, using the legal foundations of the political government. Figure 3 does not capture this, but these entities participate in the internal activities of political governments (politics, using the terminology of IE). In particular, they behave in a dynamic way, by lobbying and sending personnel into the legislatures and administrative bodies themselves.

IE sees institutional reformation as a constant change driven by two moving forces that are in constant conflict: the political and economic governments. In Section 3, I discussed two perspectives. One of these perspectives highlights that the reasonableness of capitalism is rooted in sovereignty and tin he coordinated action of thousands of bankers. The other perspective indicates that bankers increase their economic power through coordination with the political government. The theory of institutional

reformation brings the two perspectives together and identifies two moving forces, one towards the public purpose and the other deviating from it. Institutional reformation is constant and everlasting, since the two conflicting forces are constantly in motion.

5. CONCLUSION

The goal of this article is to draw from IE to show that institutions are constantly changing in response to two conflicting moving driving forces, the political government and the economic government. This finding not only sheds light on the origins of the debate in the works of Aglietta, Orléan, Théret, and others, but also facilitates the understanding of the development of French monetary institutionalism.

In particular, IE recognizes that institutions go through a process of constant reformation, reflecting the perpetual conflict between political, economic, and ethical principles (Kitagawa, in press a; in press b). Ethical principles may constitute a new order that better suits the standards of justice, equality, and fairness (Commons, 1934, pp. 766, 789). Ethical power is easy to underestimate. However, through public opinion, the labor movement, mass movements, or influencing the impressions of judges (through public opinion and social movements), ethical powers can exert pressure on the economic government to act progressively, and on the political government to reform institutions.

In Chapter XI of the IE, Commons argues that the economic power of the economic government may be difficult for the political government to curb. The banking and securities industries were criticized by politicians and societies, as they were considered a culprit in the Great Depression. This strong pressure for reform tolerated even radical experimental policies aimed at overcoming the depression. The severe pressure for reform triggered a strict regulation of the financial sector and the collective administration of interest-rates system. If we consider this case through IE's theoretical lens of institutional reformation, we find that the problematic nature of financial institutions is not only a consequence of the battle between the political government and the economic government, but it also reflects the strength of the collective, bottom-up ethical power, and suggests how long this power may last. This is an attractive feature of IE's theory of institutional reformation; it is not entirely focused on the political/economic government dichotomy, and it provides an interesting starting point for future research.

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[i] The unit of validity correlates the transaction of goods with creation of debt. Under a certain unit of validity, a price in a commodity market decides the size of debt created in the debt market. In other words, the unit of validity correlates the commodity market with the debt market.

[ii] As shown in Commons (1934, p. 242), sovereignty is the underlying "fifth party" of each bargaining transaction.

[iii] According to Commons (1934, pp. 560–590), large swings in corporations' narrow profit margins cause instability in modern capitalism.

[iv] The approach of the Federal Reserve Board is to control the discount rate and the reserve ratio (Commons, 1934, p. 610).